BACKGROUNDER
Proposal to Save Tier 3 and SB 125 (Cortese)

SUMMARY

Recent regulatory, budget and legislative changes significantly shrink the Greenhouse Gas Reduction Fund's (GGRF) annual funding and jeopardize the continuation of critical Tier 3 programs and transportation projects funded under SB 125. These programs benefit our local communities and reduce pollution across California. By implementing key policy changes and using one-time reserve funds to support CalFIRE instead of the GGRF funded programs, the Legislature has more time to work with the incoming Governor to consider and debate legislative priorities.

ISSUE & BACKGROUND

California's Cap-and-Invest Program (formerly known as Cap-and-Trade) is the state's economy-wide greenhouse gas (GHG) emissions reduction market established under AB 32 (Nunez et. al, Ch. 488, Stats. 2006). It was designed to complement other climate policies by creating a market-based "backstop" to ensure the state met its GHG targets. In 2013, the program set a cap on total emissions for applicable entities.

If companies can't successfully cap their GHG emissions, they are able to buy allowances from companies who have a surplus or from the state at auctions organized by the California Air Resources Board (CARB). Selling these allowances to firms for their continued operation generates revenue for the state. Most of this revenue is then placed in the state's GGRF, a pot of money meant to fund state projects that lower GHG emissions, improve public health, advance clean transportation, and direct significant investments toward disadvantaged and low-income communities

In 2025, the Legislature restructured the appropriations moving away from a percentage of the proceeds to a fixed dollar amount. Additionally, a new category provided up to $1 billion to be appropriated at the Legislatures' discretion. This updated funding scheme is referred to as the waterfall, referencing the strict priority order in which state climate revenues are doled out to specific legislative commitments, high-speed rail, and major environmental programs based on designated tiers. Below are the tiers in order as dictated by current statute:

Tier 1: Existing Legislative and Administration Commitments.
Tier 2: High Speed Rail ($1 billion) and Legislative Priorities ($1 billion).
Tier 3: Providing specific dollar allocations for the following programs if funding is available:

- $800 million for Affordable Housing and Sustainable Communities (AHSC)
- $400 million for Transit and Intercity Rail Capital Program (TIRCP)
- $250 million for community air protection programs
- $200 million for Low Carbon Transit Operations Program (LCTOP)
- $200 million for other fire prevention programs
- $130 million for safe drinking water

In May of 2026 CARB passed regulations to ease industry leakage and help reduce consumer costs. The regulations change how offset credits are treated under the program's cap and created the Manufacturing **Decarbonization Incentive (MDI)** program. Under the MDI program allowances would be available to covered industrial facilities to fund long-term decarbonization projects such as replacing fossil fuel equipment,

using low-carbon hydrogen, renewable energy generation, carbon capture, and methane reductions.
The Legislative Analyst's Office (LAO) estimates these changes to the cap-and-invest program significantly reduce GGRF revenues, potentially cutting them to about $2 billion annually under some scenarios.

PROBLEM

The decline in GGRF revenues, recent regulatory changes and commitments made under SB 840 (Limón, Ch. 122, Stats. 2025) leaves less than one-fifth of the promised funding for Tier 3 programs. It is critical that the state honor its commitments to these programs, including the Affordable Housing and Sustainable Communities Program (AHSC), Transit and Intercity Rail Capital Program (TIRCP), Low Carbon Transit Operations Program (LCTOP), AB 617 (C. Garcia, Ch. 136, Stats. 2017) Community Air Protection Program, and Safe & Affordable Drinking Water Program (SAFER). In addition, we should honor the state's outstanding GGRF funding commitment to public transportation made in SB 125 (Committee on Budget and Fiscal Review, Ch. 54, Stats. of 2023).

SOLUTION

California's 2026-27 enacted budget includes a historic investment in reserves to protect against economic uncertainty including over $15.070 billion in the Budget Stabilization Account/Rainy Day Fund and $4.5 billion in the Special Fund for Economic Uncertainties.

This proposal would provide a one-time $1.25 billion appropriation from the Special Fund for Economic Uncertainties (SFEU) reserve to offset the CalFIRE commitment in the GGRF. GGRF funds from CalFIRE would be redirected to fund SB 125 transit commitments and Tier 3 with priority given to TIRCP, LCTOP and AHSC.

Additionally, the proposal calls on the Legislature to adopt key common sense policy changes to fund critical Tier 3 programs:

- Establish a trigger for the MDI program.
- Cap allowances under MDI in years Tiers 2 and 3 not fully funded.
- Clarify that SB 840 applies to any money in the fund including interest earned. Earmark interest earned for SB 125 and Tier 3 with priority given to LCTOP, TIRCP & AHSC (estimated $500 million earned this fiscal year).
- Cap operating expenses and require CARB to report administrative overhead costs and recommend administrative and programming efficiencies to the Joint Legislative Budget Committee.
- Appropriate Prop 4 funds to fully fund AB 617.

FOR MORE INFORMATION

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